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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: [REDACTED]

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code (the "Code") as an organization described in section 501(c)(4). Based on the information submitted, we have concluded that you do not qualify for exemption that section. The basis for our conclusion is set forth below.

Facts:

You are organized as a non-profit mutual benefit corporation for the purpose of constructing, owning, operating, and providing housing on a cooperative limited equity basis for the benefit or your membership. Membership is limited to households who were in occupancy as of [REDACTED] or to persons and families of low and moderate income.

Article IV of your amended Articles of Incorporation provides that you are a limited equity housing cooperative pursuant to section 33007.5 of the [REDACTED] and, as such, shall satisfy certain requirements, including:

Upon the sale ... or other disposition of a Membership Interest ... no member may receive or realize consideration or value for the Membership Interest in an amount exceeding the Transfer Value, which shall be the consideration or value paid for the Membership Interest by a Member plus the value, determined by the corporation's board of directors as of the time of completion, of any capital improvements made to the Member's unit by the Member or at the Member's expense with the prior written approval of the corporation's board of directors ... provided, however, that in no event may the Transfer Value exceed the lower of: (1) The fair market value of the Membership Interest; or (2) The consideration or value paid for the Membership Interest by the Member who first occupied the unit increased by [REDACTED] % per year of such initial consideration or value, plus the value, determined by the corporation's board of directors as of

[REDACTED]

the time of completion, of any capital improvements made to the Member's unit by the Member or at the Member's expense, with the prior written approval of the corporation's board of directors.

Article III, Section 9(d) of your By-laws provides that the term "transfer value" shall mean the sum of the following: (1) the consideration paid for the membership by the first occupant of the unit involved; (2) the value, as determined by the directors, of any improvements installed at the expense of the member with the prior approval of the board of directors; and (3) an amount equal to interest, annually, on the amount described in (1) above, provided that the rate for any period shall not exceed 10 percent.

Article V, Section A, of the amended Articles of Incorporation provides that "a Membership Interest constitutes an ownership interest in the corporation coupled with an exclusive right of possession of a unit pursuant to a proprietary lease."

Article V, Section 2, of your By-laws enumerates the powers and duties of your Board of Directors. Among the powers listed is "(g) to obtain for the Corporation's housing ... (9) ... exterior and interior painting, maintenance, repair, and all of the landscaping of the Corporation property...."

In purchasing the property from the [REDACTED] Department of Transportation ([REDACTED] in [REDACTED] at a reduced price, you entered into a Regulatory Agreement with [REDACTED] dated [REDACTED]. Under Part 6(D) of the agreement, you covenant and agree that the property shall be occupied and operated as a limited-equity housing cooperative so as to remain available to persons and families of low and moderate income and to tenants already in occupancy at the time of execution of the agreement. Part 6(G) of the agreement states that Memberships shall be sold by Buyer or by a corporation member only in the manner and for the amount provided in the By-Laws. Sales shall be made only to tenants who occupied the property as of the date of the [agreement] or who are persons or families of low- or moderate-income." Part 12 provides that the agreement shall automatically cease and terminate 30 years from its date.

The Disclosure Statement to Applicants for Membership explains that cooperative housing offers certain financial benefits, including tax benefits and a limited return on the resale of membership.

Section 9 of the Disclosure Statement states the following:

In enacting Section 54235 et seq. of the Government Code, the [REDACTED] provided a means of preventing displacement and assisting low and moderate income families to meet their housing needs. This assistance included the sale of this property to the cooperative at a reduced price. To assure that this assistance benefits families, certain income limitations are necessary. Membership has therefore been limited to households who were in occupancy as of [REDACTED] or to persons and families of low and moderate income. Residents of certain

units are provided subsidies in making monthly payments if they meet the eligibility requirements described below.

Pursuant to this law ... the assistance payment for an eligible member will amount to the difference between 10 percent of his or her income and the monthly carrying charge for the unit he or she occupies. As the member's adjusted monthly income equals the full monthly carry charges for the unit he occupies, the housing assistance payments will be discontinued.

You have indicated that most of your members receive housing assistance payments.

Section 10 of the Disclosure Statement states that:

In computing his or her overall housing cost, the member may wish to consider the potential benefits of the federal income tax deductions allowed to tenant-stockholders (members) of cooperative housing under the provisions of section 217 [i.e., 216] of the Internal Revenue Code. Under this provision, provided 10 percent of the income of the cooperative consists of carrying charges received from its members, the members are entitled to deduct from their gross income their proportionate share of real estate taxes and mortgage interest paid by the Cooperative. At the end of the year, the Cooperative will advise each member of his or her proportionate share of the total amounts paid by the corporation for mortgage interest and real estate taxes.

Members pay a monthly carrying charge based on the amount needed to meet your expenses and maintain reserves. Part of the monthly carrying charge is deposited in a reserve known as the General Operating Reserve, which is intended to be available for unforeseen contingencies. Another part of the monthly carrying charge is deposited in Replacement Reserves for the purpose of defraying the costs of replacing structural components and mechanical equipment.

Law:

Section 501(a) of the Code exempts from federal income taxation organizations described in section 501(c).

Section 501(c)(4) of the Code describes civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Public Law 104-168, enacted July 30, 1996, extended the section 501(c)(3) restriction against inurement to section 501(c)(4) organizations and set forth a special transitional or savings provision for certain cooperatives, section 1311(b)(2). Section 1311(b)(2) provides that, in the case of an organization operating on a cooperative basis which, before the date of enactment of this Act was determined by the Secretary of the Treasury or his delegate to be

described in section 501(c)(4) of the Internal Revenue Code and exempt from tax under section 501(a), the allocation or return of net margins or capital to the members of such organization in accordance with its incorporating statute and bylaws shall not be treated for purposes of such Code as the inurement of net earnings of such organization to the benefit of any private shareholder or individual.

Section 1.501(c)(4)-1(a)(1) of the regulations provides that a civic league or organization may be exempt as an organization described in section 501(c)(4) if it is not organized or operated for profit and it is operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2) of the regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. The organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvement.

Rev. Rul. 74-99, 1974-1 C.B. 132, provides that a homeowners association, to qualify for exemption under section 501(c)(4) of the Code, (1) must serve a "community" which bears a reasonable recognizable relationship to an area ordinarily identified as governmental, (2) must not conduct activities directed to the exterior maintenance of private residences, and (3) the common areas or facilities it owns and maintains must be for the use and enjoyment of the general public. A community within the meaning of section 501(c)(4) of the Code and the regulations is not simply an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein. Although an exact delineation of the boundaries of a "community" contemplated by section 501(c)(4) is not possible, the term as used in that section has traditionally been construed as having reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof.

Rev. Rul. 74-17, 1974-1 C.B. 130, describes an organization that was formed by the unit owners of a condominium housing project and is operated to provide for the management, maintenance, and care of the common areas of the project. Its income is from membership assessments and its disbursements are for normal operating expenses. The ruling finds that, by virtue of the essential nature and structure of a condominium system of ownership, the rights, duties, privileges, and immunities of the members of an association of unit owners in a condominium property derive from, and are established by, statutory and contractual provisions and are inexplicably and compulsorily tied to the owner's acquisition and enjoyment of his property in the condominium. In addition, condominium ownership necessarily involves ownership in common by all condominium unit owners of a great many so-called common areas, the maintenance and care of which necessarily constitutes the provision of private benefits for the unit owners. The ruling holds that, since the organization's activities are for the private benefit of its members, it cannot be said to be operated exclusively for the promotion of social welfare. Accordingly, it does not qualify for exemption from Federal income tax under section 501(c)(4) of the Code.

Rev. Rul. 73-306, 1973-2 C.B. 179, describes an organization formed as a nonprofit corporation to promote the common interest of tenants who reside in an apartment complex. Any person regularly living in the complex is eligible for membership. The organization represents its member-tenants in negotiations with the management of the complex in order to secure better maintenance and services, and to secure reasonable rentals. The ruling concludes that the concept of social welfare implies a service or program directed at benefiting the community rather than a private group of individuals. The organization in this case is operated essentially for the private benefits of its members. Thus, it is not primarily engaged in activities for the common good and general welfare of the people of the community. Accordingly, the organization does not qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 69-280, 1969-1 C.B. 152, describes an organization incorporated for the purpose of providing specified services for the home owners in a housing development. The services consist of maintenance of the exterior walls and roofs of the individual home units. If a person purchases a unit in the housing development, he is required to become a member of the organization. The organization's bylaws provide that all members have equal voting rights. The organization is managed and controlled by a board of directors elected from and by the members. The ruling finds that the organization is performing services that its members would otherwise have to provide for themselves. It is a private cooperative enterprise for the economic benefit or convenience of the members. The ruling concludes that the organization is operated primarily for the private benefit of members and any benefits to the community are not sufficient to meet the requirement of the regulation that the organization be operated primarily for the common good and general welfare of the people of the community. Accordingly, the organization is not exempt under section 501(c)(4) of the Code.

Rev. Rul. 65-201, 1965-2 C.B. 170, holds, in part, that a cooperative organization which operates and maintains a housing development and provides housing facilities and maintenance services on a cooperative basis for the personal benefit of its tenant-owner members is not a "like organization" within the meaning of section 501(c)(12) of the Code, and does it qualify for exemption as an organization described in section 501(c)(12), or any other provision, of the Code.

Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962) concerns an organization set up by World War II veterans to provide housing to veterans of world wars. The Court observed that a corporation that provided housing on a cooperative basis lacked the necessary requirements of an organization described in section 501(c)(4) of the Code. The Court found the operation to be a private self-help enterprise with only an incidental benefit to the community as a whole, and held, therefore, that the organization was not entitled to exemption under section 501(c)(4).

In Amalgamated Housing Corp. v. Comm'r, 37 B.T.A. 817 (1938), *affirmed*, 108 F.2d 1010 (2nd Cir. 1940), the Board of Tax Appeals considered whether a limited dividend housing corporation organized under New York law was exempt under the predecessor statute to section 501(c)(4) of the Code. The working class tenants owned all the common stock of the corporation, and non-tenants owned the preferred stock. State law declared limited dividend

housing corporations to be "agencies and instrumentalities of the state." Such corporations were closely supervised by, and conducted projects authorized by, the State Board of Housing. Dividends could not exceed 6 percent, and stock could not be sold in excess of par value plus accrued dividends. The court held that the organization was not exempt, reasoning that it was operated, in part, for profit, even though limited.

Analysis:

To qualify for exemption under section 501(c)(4) of the Code, you must be operated exclusively for the promotion of social welfare by being primarily engaged in promoting the common good and general welfare of the people of the community. Furthermore, no part of your net earnings may inure to the benefit of your members.

Rev. Rul. 74-99, *supra*, defines a "community" as a geographical unit bearing a reasonable relationship to an area identified as a governmental subdivision. A community is not simply an aggregation of homes in a structured unit like a real estate subdivision. You are comprised of 98 units with an area and population similar to that of a real estate subdivision but not that of an area bearing a reasonable relationship to a governmental subdivision. Thus, your operations do not encompass a "community" for purposes of section 501(c)(4) of the Code.

You are a member-tenant organization similar to the organization described in Rev. Rul. 73-306, *supra*. You represent your members' interests in the management and maintenance of the housing development. Since your activities are directed primarily at securing better maintenance and services at lower costs for your members and only incidentally at the community at large, you are not primarily engaged in promoting the common good and general welfare of the community as required under section 501(c)(4) of the Code.

Furthermore, you provide services specifically related to the maintenance of member's homes, services that your member-tenants would otherwise have to perform for themselves. Therefore, like the organizations described in Rev. Ruls. 65-201, 69-280, and 74-17, *supra*, you are a private cooperative enterprise for the economic benefit or convenience of your members. Any benefits to the community are only incidental, and are insufficient to meet the requirements of section 501(c)(4) of the Code.

Participation in housing on a cooperative basis enables members to keep housing and maintenance costs low. It also provides members a tax benefit by allowing each member to deduct their proportionate share of the real estate taxes and mortgage interest you pay. You are like the organization in Commissioner v. Lake Forest, Inc., *supra*, which the Court found to be a self-help organization that provides only incidental benefit to the community and, thus, does not meet the requirements of section 501(c)(4) of the Code.

Finally, your earnings are allowed to inure impermissibly to the benefit of your members insofar as members receive a "transfer value" upon the resale of their membership that includes a return on their investment in the membership.

[REDACTED]

Conclusion:

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(4) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED]
[REDACTED]
[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

[REDACTED]
[REDACTED]

Acting Manager
Exempt Organizations
[REDACTED]

cc:

[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]